ANNUAL REPORT 2006

DIAZ RESOURCES LTD.

TABLE OF CONTENTS

ANNUAL MEETING

The Annual Meeting of the Shareholders of Diaz Resources Ltd. will be held at 3:00pm on Wednesday, May 16, 2007 in the Cardium Room of the Calgary Petroleum Club, 319 - 5 Avenue S.W., Calgary, Alberta.

CORPORATE PROFILE

Diaz Resources Ltd. is an oil and gas exploration and development company with land holdings and production in Canada and the United States. The Company's principal business is the exploration for and marketing of natural gas, with the majority of the Company's revenue being generated from gas production in Alberta and Texas.

The Company's current focus is on the exploration for natural gas along a deep Wilcox trend in Texas. In Canada, Diaz is presently developing shallow gas prospects in southern Alberta and oil prospects in Alberta and Saskatchewan.

CORPORATE SUMMARY

(Thousands, except per share amounts)	Years Ended December 31	
	2006	2005
Financial		
Total revenue	**$ 14,925**	$ 18,567
Cash flow from operations	**$ 8,578**	$ 12,134
per share, basic and diluted	**$ 0.14**	$ 0.20
Earnings	**$ 1,455**	$ 4,416
per share, basic and diluted	**$ 0.02**	$ 0.07
Property, plant and equipment		
Capital additions	**$ 14,230**	$ 13,194
Dispositions	**$ 157**	$ 962
Net debt	**$ 11,235**	$ 7,475
Total assets	**$ 59,745**	$ 56,588
Total shares outstanding	**63,848**	61,550
Operations		
Production		
Gas (MMcfd)	**6.0**	6.3
Oil (Bopd)	**130**	161
BOEd (6Mcf = 1Bbl)	**1,136**	1,212
Product Prices		
Gas ($/Mcf)	**$ 7.07**	$ 8.64
Oil ($/Bbl)	**$ 63.95**	$ 62.13
Reserves (proved plus probable, future costs and prices)		
Gas (Bcf)	**27.8**	30.4
Oil (MBbl)	**437.0**	440.0
BOE (Millions)	**5.1**	5.5
Present value, before tax ($Millions at 10%)	**$ 93.9**	$ 128.4
Undeveloped land holdings (net acres)		
Canada	**52,551**	70,659
United States	**1,830**	1,648
Total net acreage	**54,381**	72,307

MESSAGE TO SHAREHOLDERS

To the Shareholders

The year 2006 was difficult for Diaz and the gas industry, due to poor fundamentals impacting natural gas pricing and a steady erosion of energy stock prices which continued through early 2007. By the end of the first quarter of 2007, however, natural gas fundamentals had significantly changed for the better and the Company is optimistic for the balance of this year.

During the first quarter of 2006, natural gas prices weakened due to the unseasonably warm winter heating season and the consequent rapid build up of natural gas in storage both in Canada and the United States. Drilling for natural gas also reached record levels and resulted in extremely high service costs principally relating to drilling and completion work. As a result of these factors, natural gas prices declined during the year and reached a low of approximately $4.00 per Mcf in September 2006.

Exploration and Development

As a result of the poor commodity outlook, Diaz reduced its ongoing shallow gas drilling program in Alberta and refocused its activities on higher impact U.S. drilling, oil development drilling, land purchases, and the tie-in of existing shut-in gas wells.

United States

During 2006, Diaz conducted completion operations on both wells at Allen Ranch in Texas, drilled and cased a second well on the Hound Dog property and commenced leasing and seismic acquisition for additional prospects on the Wilcox Trend. Diaz has identified up to 16 different locations for wells on lands currently under lease and will rank and prioritize these wells for drilling during 2007 and 2008.

In Texas, follow-up 3D seismic work surrounding the Allen Ranch property led to the identification of a large potential structure to the east, "Cheney". During 2006, the acreage on the Cheney prospect was leased. In January 2007, Diaz and its partners entered into an agreement with Petrohawk Energy Corporation pursuant to which Petrohawk would acquire an interest in the prospect and act as operator. A well on the prospect is planned to commence drilling in April 2007. Diaz has a 20 percent working interest in the prospect.

Canada

Diaz's 2006 Canadian drilling program was redirected to oil prospects during most of the year with 50% of the drilling activity for the year focused on oil versus 33% in 2005. The infill natural gas drilling program was postponed for the year and is planned to re-commence during 2007.

In Alberta, the Company completed its Jaslan natural gas facilities project in November 2006, initially adding 1 MMcf per day of production, net to Diaz, and announced an Arcs oil discovery at Hays. Additional development is planned on both of these projects in 2007.

Financial

Revenue for 2006 totaled $14.9 million compared with $18.6 million in 2005. Cash flow from operations decreased to $8.6 million, or $0.14 per share compared with $12.1 million or $0.20 per share in 2005. Diaz reported earnings for the year of $1.5 million, or $0.02 per share compared with $4.4 million, or $0.07 per share, reported in 2005.

Capital expenditures for 2006 totaled $14.2 million compared with $13.2 million in 2005 and were financed from cash flow, an increase in corporate debt, and proceeds of an equity financing completed in December 2006.

Diaz completed 2006 with net debt of $11.2 million versus $7.5 million at the beginning of the year and debt repayability from cash flow from operations was 1.3 times, an increase from 0.7 times for 2005.

Production

Natural gas production for the year decreased to 6.0 MMcfd from 6.3 MMcfd for 2005 and oil production declined to average 130 BOEd for 2006 compared with 161 BOEd for the prior year.

Gas production in the United States averaged 3.0 MMcfd for 2006 compared with 2.6 MMcfd in 2005.

Reserves and Reserves Values

The independent engineering evaluation of Diaz's properties assigned proved reserves before royalties of 2.5 million BOE and total reserves before royalties totalled 5.1 million BOE at December 31, 2006. These reserve estimates result in a before tax present value of estimated future net revenues, discounted at 10%, of $93.9 million.

Business Outlook

By February 2007, natural gas storage levels in the United States and Canada had dropped below last year's levels as cold temperatures in Canada and the eastern United States contributed to larger than expected draw downs. Also, gas targeted rig activity in Canada has declined substantially. Both of these factors have contributed to the strengthening of natural gas prices in early 2007 and Diaz anticipates strong gas prices for the balance of the year.

As a result of this positive trend, the Company plans to accelerate its gas-targeted activities throughout the year. To assist in financing this expanded program, the Company raised $2 million of flow through shares, in December 2006. In addition, the Company has recently closed an issue of $7.1 million of convertible debentures. These financings greatly add to the Company's financial flexibility and will permit increased drilling and the acquisition of natural gas assets while general industry conditions are steadily recovering.

On behalf of the Board of Directors, the Company would like to thank our staff and shareholders for their support during the year.

On behalf of the Board,

Donald K Clark

D.K. Clark
Chief Operating Officer

R.W. Lamond
Chairman

March 27, 2007


NOTICE
WARNING

OPERATIONS REVIEW

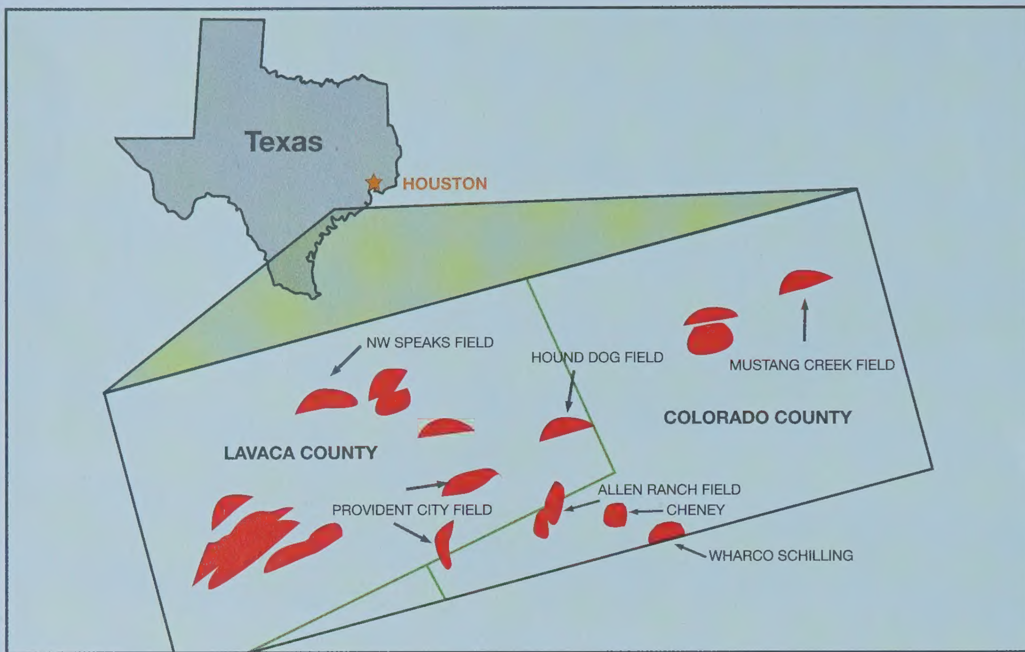
During 2006, due to the weak natural gas markets, Diaz shifted its focus from natural gas to oil exploration and development. A number of gas projects both in the United States and Canada were deferred. It is anticipated that as the gas markets improve in 2007 and Diaz will resume drilling gas wells in both the United States and Canada.

During the year, Diaz participated in the drilling of 12 wells (5.2 net) resulting in 6 gas wells (2.2 net), 5 oil wells (2.2 net) and one dry and abandoned well (0.8 net).

In the following description of Diaz's principal oil and natural gas properties, reserve amounts stated are gross reserves based on forecast cost and price assumptions, as evaluated by AJM Petroleum Consultants. The estimates of reserves and future net revenue for the individual properties may not reflect the same confidence level as estimates and reserves in future net revenue for all properties due to the effects of aggregation.

United States Drilling Program

U.S. - Wilcox Pools



Diaz's United States drilling program has been in the Wilcox deep gas trend concentrated in an area 100 miles south west of Houston, Texas. Diaz has an interest in mineral leases over 7 Wilcox structures. Four of the structures have been drilled with 100% success and the remaining 3 structures are planned to be drilled in 2007.

Diaz has identified up to 16 additional Wilcox potential locations that can be drilled on its existing mineral leases.

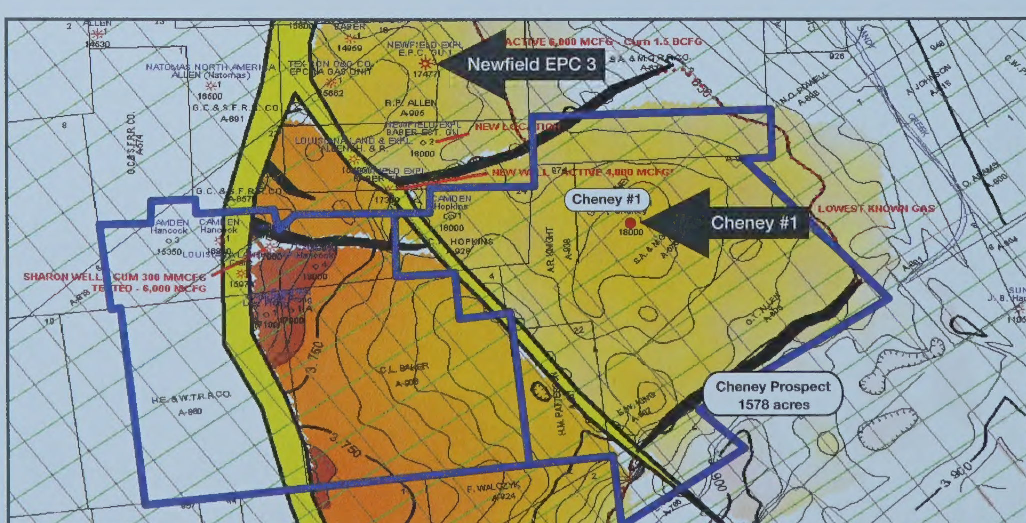
Cheney, Colorado County, Texas

In January 2007, Diaz announced an agreement with Petrohawk Energy Corporation ("Petrohawk") (NYSE: HK) pursuant to which Petrohawk will act as operator and drill a well on Diaz's "Cheney" deep Wilcox Prospect, Colorado County, Texas. The prospect is situated 1.25 miles to the east of two of Diaz's current producing wells in the Allen Ranch field. In addition, the location lies 1 mile to the southeast of two recent Newfield Exploration Company wells, which have been announced by Newfield as deep Wilcox gas producers.

Drilling is expected to commence on or about April 15, 2007. The well is to be drilled to a prospective depth of 18,100 feet and is targeting multiple deep Wilcox gas zones.

Diaz has a 20% working interest in 1,578 acres covering this prospect.

U.S. - Cheney Prospect Seismic



Allen Ranch, Colorado County, Texas

The Allen Ranch property is located approximately 100 miles southwest of Houston, Texas. Diaz has a 20% working interest in the prospect lands. Two successful wells have been drilled on the property.

The Hancock #1 well has been completed and fracture stimulated in four Wilcox sands. Production from the four sands has now been commingled, and at the end of December 2006, the well was producing 3.3 MMcfd.

Allen Ranch	Natural Gas
Reserves	
Proved developed producing	0.9 Bcf
Proved developed non-producing	- Bcf
Proved undeveloped	0.7 Bcf
Probable	3.7 Bcf
Total proved plus probable	5.3 Bcf
Q4 2006 average production	862 Mcfd

The Hancock #2 well was cased in February 2006. The well has been completed in four Wilcox gas zones. Subsequent to year end, during commingling operations a hole in the production tubing was discovered at 9,500 feet. The tubing has been pulled and has been sent out for inspection prior to proceeding with the commingling operation.

Hound Dog, Lavaca County, Texas

Diaz has a 28.1% working interest in the R. Dickson #1 well and a 25.3% working interest in the R. Dickson #2 well and 25.3% working interest in the balance of the 1,635 acres of land on the prospect.

The R. Dickson #1 well was producing 2.0 MMcfd at the end of December 2006. The R. Dickson #2 well has been completed in four Wilcox zones and commingling operations are expected to be completed in the second quarter of 2007. The R. Dickson #2 well was producing 1.9 MMcfd at the year end.

Hound Dog	Natural Gas
Reserves	
Proved developed producing	1.1 Bcf
Probable	3.8 Bcf
Total proved plus probable	4.9 Bcf
Q4 2006 average production	774 Mcfd

Provident City, Lavaca County, Texas

The Company owns a 13% working interest in two natural gas wells producing from zones in the Wilcox formation in the Provident City field, Lavaca County.

The Provident City #1 well has produced a total of 17.7 Bcf of natural gas to date and at December 31, 2006, was producing at a rate of 5.4 MMcfd (0.7 MMcfd net to Diaz). To increase production from the Provident City #1 well, plans are underway to install compression on the well which is expected to be in place during the second quarter 2007.

At year end, the Provident City #2 well was producing at a rate of 2.1 MMcfd (0.3 MMcfd net to Diaz) and has produced over 19.7 Bcf of gas to date.

Provident City	Natural Gas
Reserves	
Proved developed producing	1.1 Bcf
Probable	1.4 Bcf
Total proved plus probable	2.5 Bcf
Q4 2006 average production	1,039 Mcfd

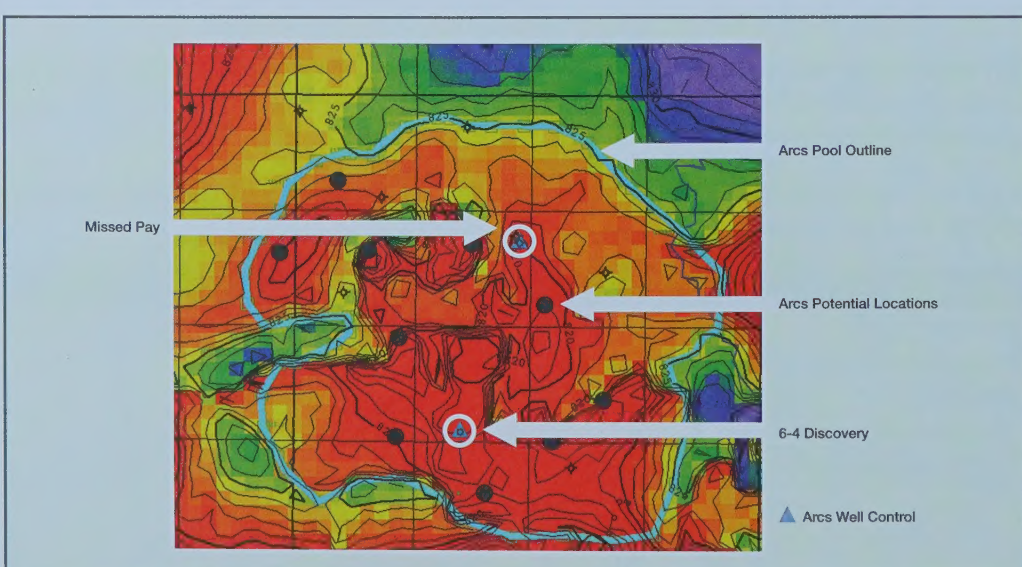
Canadian Program

Canada - Key Areas

Hays, Alberta, Canada

On November 30, 2006, Diaz announced it had discovered a new Arcs oil pool located near Hays. The discovery well has been tested in two zones. At the November 29, 2006, Alberta land sale, Diaz was successful in acquiring additional adjacent lands. Diaz and its partner control the entire 450-acre prospect. Based on seismic interpretation, Diaz has identified additional potential locations on its acreage. Diaz has a 20% working interest in the property.

Completion operations, construction of a battery and a solution gas sales line will be completed once government approvals have been received, which is anticipated to occur in the second quarter of 2007. Additional development drilling will commence during the second quarter of 2007.



Canada - Hays Wabamun Seismic

Enchant South - Hays, Alberta

In the Enchant South – Hays area, located 110 miles southeast of Calgary, Diaz has an interest in 38 producing gas wells (21.7 net wells) and 3 producing oil wells (2.1 net wells).

During 2006, Diaz drilled 2 infill gas wells on the Second White Specks trend.

Production for the year averaged 0.74 MMcfd, with an exit rate of 0.77 MMcfd compared with the average production of 1.3 MMcfd for the prior year. Diaz plans to drill an additional 13 to 23 wells over the next 3 years.

Enchant	Natural Gas
Reserves	
Proved developed producing	0.7 Bcf
Proved undeveloped	1.1 Bcf
Probable	1.6 Bcf
Total proved plus probable	3.4 Bcf
Q4 2006 average production	739 Mcfd
Land - net undeveloped acreage	1,822 Acres

Retlaw, Alberta

Diaz has interests in 39 producing gas wells (14.8 net wells), 1 shut-in gas well (0.5 net wells) and 1 oil well (0.5 net) in the Retlaw area located 90 miles southeast of Calgary, Alberta.

Similar to the Enchant property, this area is prime for drilling on reduced spacing. Diaz plans to drill up to 21 wells over the next three years.

The Company's production at Retlaw, throughout 2006, averaged 0.65 MMcfd compared to 0.8 MMcfd for 2005.

Retlaw	Natural Gas
Reserves	
Proved developed producing	0.8 Bcf
Proved undeveloped	1.7 Bcf
Probable	0.7 Bcf
Total proved plus probable	3.2 Bcf
Q4 2006 average production	651 Mcfd
Land - net undeveloped acreage	3,426 Acres

Jaslan, Alberta

In November 2006, Diaz installed a compressor station and 10 kilometres of pipeline connecting 5 gas wells (2.25 net wells) in the Jaslan area, Alberta located 75 miles northeast of Edmonton. The initial production added 1.0 MMcfd net to Diaz. Diaz anticipates this production rate to decline in the first quarter of 2007 to 0.5 MMcfd net to Diaz and remain stable thereafter.

Subsequent to year end, Diaz drilled and connected a new gas well (0.375 net) which is producing 0.5 MMcfd, 0.20 MMcfd net to Diaz.

Jaslan Area	Natural Gas
Reserves	
Proved developed producing	1.0 Bcf
Probable	0.2 Bcf
Total proved plus probable	1.2 Bcf
Q4 2006 average production	548 Mcfd
Land - net undeveloped acreage	960 Acres

Southeast Saskatchewan

Parkman Area

Diaz presently holds an interest in 6 oil wells (4.12 net) in the Parkman area, producing from the Tilston carbonates of Mississippian age.

Diaz has plans to drill a horizontal oil well (0.5 net) during the second quarter of 2007.

Parkman Area	Oil and NGLs
Reserves	
Proved developed producing	43.2 MBbl
Proved developed non-producing	10.5 MBbl
Probable	15.0 MBbl
Total proved plus probable	68.7 MBbl
Q4 2006 average production	25 Bopd
Land - net undeveloped acreage	998 Acres

Oil and Gas Reserves

Diaz also announced that an independent evaluation of the Company's oil and gas reserves, conducted by AJM Petroleum Consultants, dated March 15, 2007, has assigned proved and probable plus reserves of 5.1 million BOE to the Company's properties, having a net present value, before income tax, of $93.9 million, at a 10% discount rate.

Summary Of Oil And Gas Reserves and Net Present Values Of Future Net Revenue

As Of December 31, 2006

Reserves

Company Total	Light And Medium Oil		Natural Gas		Natural Gas Liquids	
	Gross (MBbl)	Net (MBbl)	Gross (MMcf)	Net (MMcf)	Gross (MBbl)	Net (MBbl)
Reserves Category						
Proved						
Developed Producing	198	176	7,491	5,601	24	17
Developed Non-producing	90	74	144	130	-	-
Undeveloped	0	0	7,128	5,125	13	9
Total Proved	288	250	13,553	11,391	37	26
Probable	148	129	14,242	12,186	18	14
Total Proved Plus Probable	437	379	27,795	22,772	55	40

Note: Figures may not add due to rounding.

Net Present Values Of Future Net Revenue (based on forecast prices and cost assumptions)

Company Total	Before Income Taxes Discounted At (% Per Year)					After Income Taxes Discounted At (% Per Year)				
	0	5	10	15	20	0	5	10	15	20
Reserves Category	(MM$)	(MM$)	(MM$)	(MM$)	(MM$)	(MM$)	(MM$)	(MM$)	(MM$)	(MM$)
Proved										
Developed Producing	48.4	41.5	36.6	33.0	30.1	41.2	35.3	31.1	27.9	25.4
Developed Non-producing	4.2	3.5	3.0	2.6	2.3	3.0	2.5	2.2	2.0	1.8
Undeveloped	27.7	21.1	16.8	20.2	11.6	19.7	14.8	11.6	9.5	7.9
Total Proved	80.3	66.1	56.4	49.3	43.9	63.9	52.6	44.9	39.3	35.1
Probable	92.7	55.6	37.5	27.3	21.0	65.7	39.0	26.0	18.7	14.2
Total Proved Plus Probable	173.0	121.7	93.9	76.6	65.0	129.6	91.6	70.9	58.0	49.3

Note: Figures may not add due to rounding.

More detailed information including pricing assumptions and reserve classifications can be found in the Company's Annual Information Form.

MANAGEMENT'S DISCUSSION AND ANALYSIS

March 27, 2006

The following discussion and analysis is management's assessment of Diaz's historical, financial and operating results ("MD&A"). This MD&A includes a review of certain operational results of the Company with disclosure of oil and gas activities in accordance with National Instrument 51-101, Standard of Disclosure for Oil and Gas Activities. This review should be read in conjunction with the audited consolidated financial statements of the Company for the years ended December 31, 2006 and 2005, along with the Company's Annual Information Form available on SEDAR at www.sedar.com. The reader should be aware that historical results are not necessarily indicative of future performance.

Basis of Presentation

The financial data presented herein has been prepared in accordance with accounting principles generally accepted in Canada. All dollar amounts are in Canadian dollars unless otherwise indicated. The information in relation to the 3 months ending December 31 has not been audited.

Non-GAAP Measurements – The Management's Discussion and Analysis contains the term cash flow from operations, which should not be considered an alternative to, or more meaningful as an indicator of the Company's performance than, cash flow from operating activities, as determined in accordance with accounting principles generally accepted in Canada. Diaz's determination of cash flow from operations may not be particularly comparable to that reported by other companies especially those in other industries. The reconciliation between net earnings and cash flow from operations can be found in the consolidated statements of cash flows in the audited consolidated financial statements. The Company also presents cash flow from operations per share whereby per share amounts are calculated using the weighted average shares outstanding consistent with the calculation of earnings per share. In addition, the Company presents "net debt", which is calculated as the aggregate of long term debt, if any, and working capital.

BOE Presentation – The term barrels of oil equivalent (BOE) may be misleading, particularly if used in isolation. A BOE conversion ratio of 6 Mcf: 1 Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All BOE conversions in this report are derived by converting gas to oil in the ratio of six Mcf of gas to one Bbl of oil.

Forward-looking Statements – Certain of the statements contained herein including, without limitation, financial and business prospects and financial outlook, reserve and production estimates, drilling and re-completion plans, timing of drilling, completion and tie-in of wells and capital expenditures and the timing thereof may be forward-looking statements. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue" and similar expressions may be used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties.

A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, delays resulting from or

inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources and the risk factors outlined under "Risk Factors" in the Company's Annual Information Form and elsewhere herein. The recovery and reserve estimates of Diaz's reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. As a consequence, actual results may differ materially from those anticipated in the forward-looking statements. Readers are cautioned that the foregoing list of factors is not exhaustive. Additional information on these and other factors that could effect Diaz's operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com) or at Diaz's website (www.diazresources.com). Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, including but not limited to assumptions as to the price of oil and natural gas, interest rates, exchange rates and the regulatory and legal environment in which Diaz operates, the producibility of Diaz's reserves, the capital expenditures program and future operations and other matters, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and the Company assumes no obligation to update or review them to reflect new events or circumstances except as required by applicable securities laws.

Forward-looking statements and other information contained herein concerning the oil and gas industry and the Company's general expectations concerning this industry is based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which the Company believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While the Company is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

Summary of Results

The following table provides financial data derived from the Company's financial statements for the past three years:

(Thousands, except per BOE, BOEd and per share amounts)	Years Ended December 31		
	2006	2005	[illegible]
Total revenue	**$ 14,925**	$ 18,567	$ 14,281
Cash flow from operations	**$ 8,578**	$ 12,134	$ 8,785
per share, basic and diluted	**$ 0.14**	$ 0.20	$ 0.15
Earnings for the period	**$ 1,455**	$ 4,416	$ 1,544
per share, basic and diluted	**$ 0.02**	$ 0.07	$ 0.03
Total assets	**$ 59,745**	$ 56,588	$ 46,675
Net debt	**$ 11,235**	$ 7,475	$ 9,095
Production (BOEd)	**$ 1,136**	$ 1,212	$ 1,175
Price ($ per BOE)	**$ 44.88**	$ 53.19	$ 41.20

Over the past two years, Diaz's revenue, cash flow from operations and earnings increased and decreased primarily in response to natural gas price changes as production levels remain relatively unchanged. Establishing sustainable increased production in the United States has proved to be slower than the Company had anticipated, however, Diaz believes that the U.S. program will show significant improvement in 2007 with the results of new drilling operations.

The Company's 2006 revenue, net of royalties, decreased by 20% compared with a 30% increase in 2005. The increase and subsequent decrease was primarily caused by record natural gas prices in the last half of 2005 followed by lower natural gas prices during the third and fourth quarter of 2006 as compared to the natural gas spikes during those quarters in 2005.

Operations

Diaz is primarily a natural gas producer with 89% of its production in 2006 coming from natural gas wells. Diaz owns interests in producing properties in Alberta and Saskatchewan in Canada, and in Texas in the United States.

Increased gas production from newly completed zones in wells on the Wilcox trend in Texas offset production declines from the Provident City wells and U.S. gas production increased 16% to an average of 3.0 MMcfd for the 2006 year compared with 2.6 MMcfd for 2005. Diaz anticipates U.S. gas production will be higher in 2007 as additional zones in the Dickson #2 well are completed and when mechanical difficulties with the Hancock #2 well have been rectified and the well is returned to production.

In Canada, natural gas production continued to decline in the Enchant and Carmangay areas as the Company's planned infill drilling operations were delayed in response to declining gas prices and increased costs. This decline was partially arrested as the Company tied-in five natural gas wells at Jaslan during October 2006. The Jaslan field initially added approximately 1.0 MMcfd net to the Company when production began during November 2006.

The Company's oil production decreased during the year as a result of declines in oil production from Harmattan oil well. The Company's overall production declined by 6% to 1,136 BOEd. Diaz believes this decline will be reversed when production has been restored in all of its Wilcox gas wells and when new wells in Hays, Enchant and Jaslan have been placed on production.

Where meaningful, the following production information has been segmented for each of the Company's geographic areas of operations.

Oil & Gas Production	Three Months Ended December 31		Years Ended December 31	
	2006	2005	**2006**	2005
Gas - Canada				
Enchant	**739**	1,139	**845**	1,339
Retlaw	**651**	885	**796**	821
Harmattan	**212**	343	**255**	192
Carmangay	**232**	294	**237**	435
Therien	**283**	244	**231**	232
Jaslan	**548**	24	**163**	104
Provost	**68**	44	**74**	106
Iron Springs	**62**	70	**69**	91
Other	**281**	443	**354**	398
Gas - Canada (Mcfd)	**3,076**	3,486	**3,024**	3,718
Oil & Liquids - Canada				
Harmattan	**24**	72	**41**	72
Parkman	**25**	26	**34**	29
Other	**34**	22	**31**	32
Red Earth	**8**	12	**10**	12
Oil & Liquids - Canada (BOEd)	**91**	132	**116**	145
BOEd - Canada (6Mcf = 1Bbl)	**603**	713	**620**	764
Gas - U.S.				
Provident City	**1,039**	1,388	**1,098**	1,521
Allen Ranch	**862**	1,121	**1,040**	505
Hound Dog	**774**	1,204	**817**	482
Mustang Creek	**47**	69	**53**	68
Other	**7**	7	**4**	11
Gas - U.S. (Mcfd)	**2,729**	3,789	**3,012**	2,587
Oil & Liquids - U.S.				
Provident City	**15**	14	**13**	15
Other	**1**	3	**1**	1
Oil & Liquids - U.S. (BOEd)	**16**	17	**14**	16
BOEd - U.S. (6Mcf = 1Bbl)	**471**	648	**516**	447
Gas - Company (Mcfd)	**5,805**	7,275	**6,036**	6,305
Oil and Liquids - Company (BOEd)	**107**	149	**130**	161
BOEd - Company	**1,074**	1,362	**1,136**	1,212

Product Prices	Three Months Ended December 31		Years Ended December 31	
	2006	2005	2006	2005
Canada				
Gas ($/Mcf)	$ 6.61	$ 9.84	$ 6.84	$ 7.76
Oil and liquids ($/Bbl)	$ 54.94	$ 66.23	$ 62.96	$ 61.65
$/BOE	$ 41.93	$ 60.37	$ 45.15	$ 49.43
U.S.				
Gas ($/Mcf)	$ 6.83	$ 12.34	$ 7.30	$ 9.90
Oil and liquids ($/Bbl)	$ 63.96	$ 70.60	$ 71.91	$ 66.53
$/BOE	$ 41.77	$ 73.94	$ 44.55	$ 59.63
$/BOE - Company	$ 41.86	$ 66.83	$ 44.88	$ 53.19

Natural gas prices declined throughout 2006 from record high levels being received in Q4 2005. This decline was the result of an unusually warm winter and the resulting increasing levels of gas in storage. Diaz received an average price of $6.61 per Mcf in Q4 2006, 33% lower than the price received a year earlier. In the U.S., the price decline was more dramatic with the Company receiving an average of $6.83 per Mcf in Q4 2006, a 45% decline from Q4 2005.

The Company's average oil price increased by 2% in Canada where most of the Company's oil is produced. Because 89% of the Company's product is natural gas, the decline in gas price resulted in a 16% decline in average price received per BOE in 2006.

Subsequent to the year end, the trend of declining gas prices has been reversed. The Company's outlook for natural gas prices is very positive for 2007. Gas storage inventories have been drawn down to more seasonal levels combined with a sharp reduction of Canadian drilling for gas. The drop in drilling activity will delay any significant increase in deliverability for the near term which should support strong natural gas prices through the upcoming year.

The Company anticipates that natural gas prices will range between $6.50 and $8.50 per Mcf throughout 2007. In addition, Diaz has entered into various fixed contracts through the first quarter of 2008 agreeing to sell approximately 1.4 MMcfd of natural gas at floor prices from $7.81 per Mcf to $8.99 per Mcf.

Revenue from Oil and Gas Production (Thousands)	Three Months Ended December 31		Years Ended December 31	
	2006	2005	2006	2005
Canada				
Natural gas	$ 1,869	$ 3,156	$ 7,554	$ 10,532
Oil and natural gas liquids	$ 459	$ 805	$ 2,656	$ 3,258
Total - Canada	$ 2,328	$ 3,961	$ 10,210	$ 13,790
U.S.				
Natural gas	$ 1,716	$ 4,301	$ 8,020	$ 9,345
Oil and natural gas liquids	$ 93	$ 110	$ 374	$ 388
Total - U.S.	$ 1,809	$ 4,411	$ 8,394	$ 9,733
Total Production Revenue - Company	$ 4,137	$ 8,372	$ 18,604	$ 23,523

The significant decline in gas prices combined with a 4% decline in the Company's natural gas production were the principal reason for a 21% decline in production revenues, with $4.2 million or 86% of the reduction in revenues taking place in the fourth quarter of 2006 when the decline in prices on a year-over-year basis was most significant.

Diaz anticipates a return to higher prices and increases in natural gas production in the United States and Canada will result in production revenue growth in 2007. Increased production in the U.S. is anticipated at Provident City with the installation of additional compression and at Hound Dog with the completion of additional zones. The Hancock #2 well should add production when the new casing has been installed. In Canada, additional production is anticipated as new wells are tied-in at Hays, Enchant and Jaslan.

Royalties (Thousands, except per BOE and percentage amounts)	Three Months Ended December 31		Years Ended December 31	
	2006	2005	**2006**	2005
Canada				
Crown	**$ 149**	$ 544	**$ 906**	$ 1,435
Freehold	**107**	176	**497**	735
Alberta Royalty Tax Credit (ARTC)	**137**	(112)	**14**	(289)
Royalties, net of ARTC	**$ 393**	$ 608	**$ 1,417**	$ 1,881
per BOE	**$ 7.08**	$ 9.27	**$ 6.27**	$ 6.74
Royalties as a percentage of revenue	**16.9%**	15.3%	**13.9%**	13.6%
U.S.				
Royalties	**$ 525**	$ 1,507	**$ 2,360**	$ 3,186
per BOE	**$ 12.12**	$ 25.26	**$ 12.53**	$ 19.52
Royalties as a percentage of revenue	**29.0%**	34.2%	**28.1%**	32.7%
Total Royalties - Company	**$ 781**	$ 2,227	**$ 3,763**	$ 5,356
per BOE	**$ 7.90**	$ 17.78	**$ 9.08**	$ 12.11

In Canada, royalty rates were relatively unchanged at 13.9% of revenue compared with an average of 13.6% in 2005. Diaz had an adjustment to its ARTC as a result of an administrative review by the Alberta government. The review resulted in certain properties being disallowed for ARTC. The Alberta government has discontinued the Royalty Tax Credit program effective December 31, 2006. Diaz anticipates royalty rates will average approximately 15% during 2007.

United States royalties decreased slightly as a percentage of revenue due to lower state severance taxes on certain wells producing from deep formations.

Operating and Transportation Expense (Thousands, except per BOE amounts)	Three Months Ended December 31		Years Ended December 31	
	2006	2005	2006	[illegible]
Canada	**$ 745**	$ 757	**$ 2,939**	$ 2,943
per BOE	**$ 13.42**	$ 11.54	**$ 13.00**	$ 10.55
U.S.	**$ 339**	$ 126	**$ 613**	$ 270
per BOE	**$ 7.83**	$ 2.11	**$ 3.25**	$ 1.65
Total Expense - Company	**$ 1,084**	$ 883	**$ 3,552**	$ 3,213
per BOE	**$ 10.97**	$ 7.05	**$ 8.57**	$ 7.27

During the year, operating costs increased in Canada and the U.S., to $13.00 per BOE and $3.25 per BOE, respectively. Overall for 2006, total operating costs increased by 18% to average $8.57 per BOE from $7.27 per BOE in 2005. This increase is a result of prevailing cost pressure in the oil and gas sector. In Q4 2006, the U.S. operating costs increased primarily as a result of property taxes on the Allen Ranch and Hound Dog properties.

Overhead & Stock Based Compensation (Thousands, except per BOE amounts)	Three Months Ended December 31		Years Ended December 31	
	2006	2005	2006	[illegible]
Cash compensation costs	**$ 509**	$ 595	**$ 1,344**	$ 1,326
Stock based compensation costs	**$ (3)**	$ 62	**$ 278**	$ 589
Other overhead costs	**$ 271**	$ 250	**$ 1,347**	$ 1,013
Recovered from third parties	**$ (175)**	$ (94)	**$ (645)**	$ (324)
Capitalized	**$ (55)**	$ (51)	**$ (191)**	$ (177)
Net overhead	**$ 547**	$ 762	**$ 2,133**	$ 2,427
per BOE	**$ 5.54**	$ 6.08	**$ 5.15**	$ 5.49

Cash compensation and other overhead costs totaled $2.7 million for 2006, an increase of 17% over last year's total of $2.3 million. This is attributable to general inflationary costs in the very active oil and gas sector combined with an expansion of the staffing complement and an increase in office space.

For Q4 2006, cash compensation and other overhead costs totaled $780,000 compared to $845,000 in Q4 2005 as the Company reduced its annual incentive payment to staff in December 2006 to $217,000 from $466,000 in the prior year offsetting increases in overall expenditures.

Net overhead costs decreased to $2.1 million for 2006 primarily as a result of lower stock based compensation costs of $278,000 compared with $589,000 in 2005 and higher recoveries from third parties of $645,000 versus $324,000 in 2005.

Interest Expense (Thousands, except per BOE and percentage amounts)	Three Months Ended December 31		Years Ended December 31	
	2006	2005	**2006**	[illegible]
Average bank debt	**$ 9,667**	$ 8,726	**$ 9,260**	$ 8,764
Interest expense	**$ 205**	$ 121	**$ 670**	$ 493
per BOE	**$ 2.08**	$ 0.97	**$ 1.62**	$ 1.11
Average interest rate	**6.8%**	5.5%	**6.5%**	5.2%

Total interest expense increased to $670,000 for 2006 from $493,000 reported one year earlier. This was due to higher interest rates and higher average bank debt. Subsequent to the year end, the Company announced the issue of $7.1 million convertible debentures having an interest rate of 8.75%. The increased level of debt together with the higher rate will have the effect of increasing the Company's interest costs in the future.

Income Taxes (Thousands)	Three Months Ended December 31		Years Ended December 31	
	2006	2005	**2006**	[illegible]
Canada				
Current tax expense	**$ 12**	$ 6	**$ 33**	$ 26
Future tax expense (recovery)	**(303)**	(287)	**(1,264)**	(453)
Total - Canada	**$ (291)**	$ (281)	**$ (1,231)**	$ (427)
U.S.				
Current tax expense	**$ 154**	$ 308	**$ 236**	$ 863
Future tax expense (recovery)	**(79)**	427	**805**	680
Total - U.S.	**$ 75**	$ 735	**$ 1,041**	$ 1,543
Total - Company	**$ (216)**	$ 454	**$ (190)**	$ 1,116

Current taxes paid in Canada consist primarily of capital tax and Saskatchewan provincial tax, which are based on the Company's balance sheet and gross revenue in the province. In Canada, the Company has estimated income tax pools that, together with its planned exploration and development expenditures, should be sufficient to allow Diaz to defer current taxes payable during 2007.

In the United States, the Company was cash taxable in 2005 and 2006. Diaz plans to increase capital spending in the U.S. during 2007. This will reduce the amount of current taxes otherwise payable; however, Diaz anticipates that it will be taxable on a current basis in 2007.

At year end, Diaz had the following tax pools available to defer current income tax:

Tax Pools (Thousands)	Years Ended December 31	
	2006	2005
Canadian exploration expense	$ 9,813	$ 8,431
Canadian development expense	5,778	3,883
Undepreciated capital cost	6,775	5,700
Canadian oil and gas property expense	5,117	4,941
Other	214	244
	27,697	23,199
U.S. tax pools	3,183	2,238
Total	$ 30,880	$ 25,437

During 2005, Diaz issued $2.0 million of flow-through shares and has satisfied the obligation to spend $2.0 million on exploration costs prior to December 31, 2006. In December 2006, the Company issued another $2.0 million of flow-through shares and has to spend this amount on exploration costs prior to December 31, 2007.

The tax deduction from these expenditures has been renounced to the purchasers of the flow-through shares in the year issued.

Depletion, Depreciation & Accretion (Thousands, except per BOE amounts)	Three Months Ended December 31		Years Ended December 31	
	2006	2005	2006	2005
Canada				
Depletion and depreciation	$ 1,399	$ 1,405	$ 5,184	$ 5,190
ARO accretion	91	50	252	200
Total - Canada	$ 1,490	$ 1,455	$ 5,436	$ 5,390
per BOE	$ 26.84	$ 22.18	$ 24.04	$ 19.32
U.S.				
Depletion and depreciation	$ 522	$ 501	$ 1,848	$ 1,440
ARO accretion	1	-	2	2
Total - U.S.	$ 523	$ 501	$ 1,850	$ 1,442
per BOE	$ 12.07	$ 8.40	$ 9.82	$ 8.83
Total - Company	$ 2,013	$ 1,956	$ 7,286	$ 6,832
per BOE	$ 20.37	$ 15.61	$ 17.57	$ 15.45

The Company's depletion, depreciation and accretion costs have increased to $17.57 per BOE from $15.45 per BOE in 2005. This increase in the depletion rate is the result of higher finding and development costs for the Company over the past two years. Depletion expense is calculated based on the Company's proved reserves. As the Company completes wells and converts probable reserves to proved, this rate should decline.

Exploration and Development Costs

During 2006, Diaz incurred $14.3 million on additions to its oil and gas asset base.

A summary of the capital expenditures and the respective increase or decrease in estimated future capital required to produce the Company's proved and probable reserves are summarized below for the past three years:

Fixed Asset Additions (Thousands)	Years Ended December 31			Three Year Total
	2006	2005	2004	
Canada				
Land	$ 1,314	$ 1,456	$ 1,649	$ 4,419
Acquisitions	-	-	-	-
Geological & geophysical	582	932	874	2,388
Drilling	4,467	5,233	5,288	14,988
Facilities	2,781	1,632	2,733	7,146
Cost incurred	9,144	9,253	10,544	28,941
Increase (decrease) in future costs required to produce:				
Proven reserves	(1,123)	3,176	(985)	1,068
Probable reserves	(7,549)	1,412	(986)	(7,123)
Increase (decrease) in future costs	(8,672)	4,588	(1,971)	(6,055)
Total Finding Costs - Canada	$ 472	$ 13,841	$ 8,573	$ 22,886
U.S.				
Land	$ 920	$ 822	$ 127	$ 1,869
Corporate acquisitions	-	-	-	-
Geological & geophysical	177	66	27	270
Drilling	2,917	2,215	1,226	6,358
Facilities	1,120	838	226	2,184
Cost incurred	5,134	3,941	1,606	10,681
Increase (decrease) in future costs required to produce:				
Proven reserves	(1,629)	1,104	793	268
Probable reserves	(1,261)	4,205	(201)	2,743
Increase (decrease) in future costs	(2,890)	5,309	592	3,011
Total Finding Costs - U.S.	$ 2,244	$ 9,250	$ 2,198	$ 13,692
Corporate				
Total Finding Costs - Proved	$ 11,526	$ 17,474	$ 11,958	$ 40,958
Total Finding Costs - P+P	$ 2,716	$ 23,091	$ 10,771	$ 36,578

Finding Costs per BOE	Years Ended December 31			Three Year Total
	2006	2005	2004	
Proved Reserves				
Total cost of proved additions ($M)	**$ 11,526**	$ 17,474	$ 11,958	$ 40,958
Proved reserve additions (MBOE)	**108**	555	562	1,225
Finding & development cost ($/BOE)	**$ 106.72**	$ 31.48	$ 21.28	$ 33.44
Proved and Probable Reserves				
Total cost of P+P additions ($M)	**$ 2,716**	$ 23,091	$ 10,771	$ 36,578
P+P reserve additions (MBOE)	**39**	1,187	800	2,026
Finding & development cost ($/BOE)	**$ 69.64**	$ 19.45	$ 13.46	$ 18.05

Finding and development costs are calculated by dividing the total cost in exploration and development for the period, plus the increase or decrease in estimated future costs required to produce the reserves, excluding the cost of reserve acquisitions and dispositions, by the total reserves added during the period, excluding reserves acquired and disposed of.

The aggregate of the exploration and development costs incurred in the most recent financial year and the changes during that year in estimated future development costs generally will not reflect total finding and development costs related to additions to reserves for that year. Additions to reserves include changes to previous estimates of reserve values.

Diaz's finding and on-stream cost in 2006 averaged $69.64 per BOE of proved and probable reserves. The calculation of finding costs is distorted in the current year as improvements to Proved and Probable reserves from drilling activities of 1,222 MBOE were offset by a downward technical revision to Proved and Probable reserves of 1,183 MBOE for the year netting a small gain in overall reserves for 2006.

The development of the Wilcox gas pools in the U.S. will take place over several years. Based on the interpretation of logs and seismic data, Diaz has identified a number of potential productive gas sands in each of the wells drilled on the Allen Ranch and Hound Dog properties. However, no reserves can be assigned to these sands until such time as the sands have been completed and establish gas flow rates. Sound engineering practice requires the sands be completed and evaluated from the lowest producing zones in the well, upwards. As a result, the Company's finding and on-stream costs will be weighted to the early years of the exploration cycle. If the Company's interpretation of the logs in the potentially productive zones is correct and the development of the prospective sands is successful, the finding costs should decline over the development period.

BOEs may be misleading, particularly if used in isolation. A BOE conversion factor of 6 Mcf to 1 Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Quarterly Financial Information

(Thousands, except per share amounts)	Three Months Ended							
	2006				2005			
	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31
Production (BOEd)	1,074	1,059	1,217	1,196	1,362	1,152	1,210	1,121
Price ($/BOE)	$ 41.86	$ 40.82	$ 42.63	$ 53.63	$ 66.83	$ 53.42	$ 47.03	$ 42.75
Total revenue	$ 3,250	$ 3,145	$ 3,885	$ 4,645	$ 6,293	$ 4,585	$ 4,253	$ 3,436
Cash flow from operations	$ 1,244	$ 1,816	$ 2,199	$ 3,319	$ 4,275	$ 3,299	$ 2,492	$ 2,068
per share	$ 0.02	$ 0.03	$ 0.04	$ 0.05	$ 0.07	$ 0.05	$ 0.05	$ 0.03
Earnings (loss)	$ (314)	$ (591)	$ 1,353	$ 1,007	$ 2,094	$ 1,101	$ 831	$ 390
per share (diluted)	$ -	$ (0.01)	$ 0.02	$ 0.02	$ 0.03	$ 0.02	$ 0.01	$ 0.01
Fixed asset additions (net)	$ 3,914	$ 3,535	$ 1,521	$ 5,249	$ 5,994	$ 1,261	$ 2,717	$ 2,260
Total assets	$ 59,745	$ 58,940	$ 55,892	$ 56,657	$ 56,588	$ 50,197	$ 48,563	$ 46,455
Net debt	$ 11,235	$ 10,387	$ 8,701	$ 9,310	$ 7,475	$ 7,651	$ 9,604	$ 9,211

Diaz's production increased throughout 2005 to a high of 1,362 BOEd in Q4 2005, however, as natural gas prices began to decline in 2006, Diaz delayed development operations and production declined through the year to 1,074 BOEd in Q4 2006. As a result of this production trend and price increase through 2005 and decrease through 2006, the Company's revenues increased throughout 2005 to a high of $6.3 million in Q4 2005 and have subsequently declined for three of the last four quarters. This trend is also reflected in cash flow from operations and earnings over the last two years. Capital expenditures exceed cash flow and equity financings have resulted in the Company's net debt increase to $11.2 million in 2006.

Liquidity and Capital Resources

Diaz completed Q4 2006 with a net debt of $11.2 million compared with $7.5 million at the end of 2005. The Company has a credit facility of $11.5 million, of which $10.7 million was drawn at December 31, 2006. In the first quarter of 2007, the Company completed a financing raising $7.1 million through the issue of convertible debentures.

The Company's capital expenditure plans for 2007 will be based on estimated cash flow for the year together with the proceeds from the convertible debentures financing completed subsequent to year end.

Normal Course Issuer Bid

During the twelve month ended December 31, 2006, Diaz repurchased 45,000 of its Common Shares at an average price of $0.89 per share.

Diaz was authorized to repurchase up to 3,092,000 Common Shares through the facilities of the Toronto Stock Exchange pursuant to a normal course issuer bid, which expires on September 10, 2007. Shares repurchased pursuant to the bid are cancelled.

Business Risk

The Company is engaged in the exploration, development, production and acquisition of crude oil and natural gas. Diaz's business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced.

Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates and currency exchange rates. Operational risks include competition, environmental factors, reservoir performance uncertainties, a complex regulatory environment and safety concerns.

The Company minimizes its business risks by focusing on a select group of properties. This enables Diaz to have more control over the timing, direction and costs related to exploration and development opportunities. The geological focus is on areas in which the prospects are well understood by management. Technological tools are regularly used to reduce risk and increase the probability of success. The Company closely follows all government regulations and has an up-to-date emergency response plan that has been communicated to all field operations by management. Diaz also carries insurance coverage to protect itself against potential losses.

Employing a highly motivated and experienced staff of petroleum and natural gas professionals further minimizes the business risk.

The Company is exposed to commodity price and market risk for its principal products of petroleum and natural gas. Commodity prices are influenced by a wide variety of factors of which most are beyond the control of Diaz. To manage this risk, the Company has entered into a number of forward sales contracts in relation to gas prices.

Contractual Obligations and Commitment

In the normal course of business, Diaz is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancelable. Diaz has an obligation with respect to an operating lease covering its office lease for a minimum payment of $205,000 in 2007.

The Company also has asset retirement obligations with respect to the abandonment and reclamation of wells and facilities owned by the Company. Diaz includes the present value of the estimated liabilities for such costs on its balance sheet. The total estimated cost of these liabilities at December 31, 2006 was $2.6 million.

Off Balance Sheet Arrangements

Diaz does not currently utilize any off balance sheet arrangements with unconsolidated entities to enhance liquidity and capital resource positions or for any other purpose.

Related Party Transactions

At December 31, 2006, Humboldt Capital Corporation and certain of its officers and directors owned 34% of the outstanding shares of Diaz. Diaz and Humboldt have certain common officers and directors. Humboldt's business includes the ownership, acquisition and sale of securities in other companies in the oil and gas industry and Humboldt owns significant interests in companies in the oil and gas sector, which compete with Diaz and operate jointly with Diaz, from time to time, in certain areas.

Diaz and Sharon Energy Ltd. have certain common officers and directors. In addition, at December 31, 2006, Humboldt Capital Corporation and its directors and officers owned approximately 37% of the outstanding shares of Sharon. During the past two years, Sharon participated in an exploration and land acquisition program in southern Alberta, operated by Diaz, and Diaz participated in an exploration and land acquisition program in Texas, operated by Sharon. At December 31, 2006, Sharon owed Diaz $203,000 (2005 - $376,000) through the normal course of business.

During 2006, Diaz provided certain overhead services to Humboldt Capital Corporation and Humboldt reimbursed Diaz in the amount of $204,000 (2005 - $120,000).

Application of Critical Accounting Estimates

Diaz's financial statements have been prepared in accordance with generally accepted accounting principles in Canada. The significant accounting policies used by Diaz are disclosed in Note 1 to the Consolidated Financial Statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The following discusses such accounting policies and is included in Management's Discussion and Analysis to aid the reader in assessing the critical accounting policies and practices of the Company and the likelihood of materially different results being reported.

Diaz's management reviews its estimates regularly. The emergence of new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates.

The following assessment of significant accounting policies is not meant to be exhaustive. The Company might realize different results from the application of new accounting standards promulgated, from time to time, by various rule-making bodies.

Proved Oil and Gas Reserves

Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves.

The estimated quantities of proved crude oil, natural gas liquids including condensate and natural gas that geological and engineering data demonstrate with reasonable certainty can be recovered in future years from known reservoirs under existing economic and operating conditions, i.e. prices and costs as of the date the estimate is made.

Reserves are considered proved if they can be produced economically as demonstrated by either actual production or conclusive formation tests.

The oil and gas reserve estimates are made using all available geological and reservoir data as well as historical production data. Estimates are reviewed and revised as appropriate. Revisions occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Company's plans. The effect of changes in proved oil and gas reserves on the financial results and position of the Company is described under the heading "Full Cost Accounting for Oil and Gas Activities."

Full Cost Accounting for Oil and Gas Activities

Depletion Expense

The Company uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development are capitalized whether successful or not. The aggregate of net capitalized costs and estimated future development costs less estimated salvage values is amortized using the unit of production method based on estimated proved oil and gas reserves.

An increase in estimated proved oil and gas reserves would result in a corresponding reduction in depletion expense. A decrease in estimated future development costs would result in a corresponding reduction in depletion expense.

Withheld Costs

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly and any impairment is transferred to the costs being depleted.

Impairment of Long-Lived Assets

The Company is required to review the carrying value of all property, plant and equipment, including the carrying value of oil and gas assets, for potential impairment. Impairment is indicated if the carrying value of the long-lived asset or oil and gas cost center is not recoverable by the future undiscounted cash flows. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to earnings.

Asset Retirement Obligations

The Company is required to provide for future removal and site restoration costs. The Company must estimate these costs in accordance with existing laws, contracts or other policies. These estimated costs are charged to earnings and the appropriate liability account over the expected service life of the asset.

When the future removal and site restoration costs cannot be reasonably determined, a contingent liability may exist. Contingent liabilities are charged to earnings when management is able to determine the amount and the likelihood of the future obligation.

Legal, Environmental Remediation and Other Contingent Matters

The Company is required to both determine whether a loss is probable based on judgment and interpretation of laws and regulations and determine that the loss can reasonably be estimated. When the loss is determined it is charged to earnings.

The Company's management must continually monitor known and potential contingent matters and make appropriate provisions by charges to earnings when warranted by circumstance.

Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

Financial Reporting Update

Effective March 2006, all reporting issuers in Canada are subject to new disclosure requirements as per Multilateral Instrument 52-109 ("MI 52-109"). As a result of MI 52-109, the Chief Executive Officer and Chief Financial Officer have to certify that they have designed internal controls over financial reporting to provide reasonable assurance over the reliability of financial reporting and the preparation of external financial statements in compliance with GAAP. In addition, they are subject to a second certification that they have ensured disclosure of changes in internal control that has had or may have a material effect on the Company's internal control.

No changes were made to the internal controls over financial reporting during the year.

The Canadian Institute of Chartered Accountants ("CICA") is continuously modifying the CICA Handbook with new or amended accounting standards. Diaz constantly monitors and reviews changes to the CICA Handbook and has determined that no changes were required to its accounting policies during the year ended December 31, 2006. Also, the new CICA Handbook Section 3855, "financial instruments — recognition and measurement", that comes into effect January 1, 2007, will not materially impact the Company and will not require any change to current accounting policies.

Internal Controls over Financial Reporting

The Chief Executive Officer and Chief Financial Officer of Diaz are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Management has assessed the design of the Company's internal control over financial reporting as at December 31, 2006 and has certified that there were no changes to the controls over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Disclosure Controls and Procedures

The Company has established disclosure controls, procedures and corporate policies so that the consolidated financial results are presented accurately, fairly and timely. The disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in reports filed or submitted under applicable securities regulation is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. All internal control systems, no matter how well designed, have inherent limitations. Therefore, these systems provide reasonable, but not absolute assurance, that financial information is accurate and complete.

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was conducted as of December 31, 2006 by and under the supervision of management, including the Chief Executive Officer and Chief Financial Officer. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of December 31, 2006, the disclosure controls and procedures were effective at providing such reasonable assurance.

Outlook

By February 2007, natural gas storage levels in the United States and Canada had dropped below last year's levels as cold temperatures in Canada and the eastern United States contributed to larger than expected draw downs. Also, gas targeted rig activity in Canada has declined substantially. Both of these factors have contributed to the strengthening of natural gas prices in early 2007 and Diaz anticipates strong gas prices for the balance of the year.

As a result of this positive trend, the Company plans to accelerate its gas-targeted activities throughout the year. To assist in financing this expanded program, the Company raised $2 million of flow through shares, in December 2006. In addition, the Company has recently closed an issue of $7.1 million of convertible debentures. These financings greatly add to the Company's financial flexibility and will permit increased drilling and the acquisition of natural gas assets while general industry conditions are steadily recovering.

Management's Report

The accompanying financial statements of Diaz Resources Ltd. have been prepared by management in accordance with generally accepted and consistently applied accounting principles. The Company's accounting procedures and related systems of internal controls are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. In recognizing that the Company is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these financial statements have been prepared accordingly and within reasonable limits of materiality. Further, management is satisfied that the financial information throughout the balance of this annual report is consistent with the information presented in the financial statements.

PricewaterhouseCoopers LLP have been appointed by the shareholders of Diaz Resources Ltd. and serve as the Company's independent auditors. They have examined the financial statements of the Company for the years ended December 31, 2006 and 2005. The Audit Committee has reviewed these statements with management and the auditors, and has reported to the Board of Directors. The Board has approved the financial statements of Diaz Resources Ltd., which are contained in this annual report.

Robert W. Lamond
President and Chairman of the Board

Brad R. Perry
Chief Financial Officer

March 27, 2007

Auditors' Report

To the Shareholders of Diaz Resources Ltd.

We have audited the consolidated balance sheets of Diaz Resources Ltd. as at December 31, 2006 and 2005 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Calgary, Alberta

March 27, 2007

CONSOLIDATED BALANCE SHEETS

(Thousands) As at	December 31 2006	December 31 2005
ASSETS		
Current Assets		
Cash	$ 2,082	$ 1,585
Accounts receivable	3,966	8,341
Prepaid expense	302	260
	6,350	10,186
Property, plant and equipment (Note 3)	88,306	74,279
Accumulated depletion and depreciation	(34,911)	(27,877)
	53,395	46,402
Total Assets	$ 59,745	$ 56,588
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	$ 6,705	$ 9,800
Income tax payable	168	679
Bank debt (Note 2)	10,712	7,182
	17,585	17,661
Other Liabilities		
Future income tax liability (Note 5)	5,757	5,598
Asset retirement obligation (Note 6)	2,596	2,535
Total Other Liabilities	8,353	8,133
	25,938	25,794
SHAREHOLDERS' EQUITY		
Share capital (Note 4)	19,496	18,175
Contributed surplus	1,126	862
Retained earnings	13,185	11,757
	33,807	30,794
Total Liabilities and Shareholders' Equity	$ 59,745	$ 56,588

Approved by the Board:

R.W. Lamond
Director

Donald K Clark

D.K. Clark
Director

Consolidated Statement of Operations and Retained Earnings

(Thousands, except per share amounts)	Years Ended December 31 2006	2005
Revenue		
Production	$ 18,604	$ 23,523
Royalties - net of ARTC	(3,777)	(5,067)
Interest and other income	98	111
	14,925	18,567
Expenses		
Operating and transportation	3,552	3,213
Overhead	1,855	1,838
Stock based compensation	278	589
Interest expense	670	493
Foreign exchange loss	19	70
Depletion, depreciation and accretion	7,286	6,832
	13,660	13,035
Earnings before income tax	1,265	5,532
Income tax (Note 5)		
Current expense	270	889
Future tax expense (recovery)	(460)	227
Total income tax expense (recovery)	(190)	1,116
Net earnings for the period	1,455	4,416
Excess of cost over paid up capital on share repurchases	(27)	(23)
Retained earnings, beginning of year	11,757	7,364
Retained earnings, end of year	$ 13,185	$ 11,757
Earnings per share, basic and diluted	$ 0.02	$ 0.07

Consolidated Statement of Cash Flows

(Thousands)	Years Ended December 31	
	2006	2005
Cash provided by (used for):		
Operating Activities		
Earnings for the year	$ 1,455	$ 4,416
Non-cash items:		
Depletion, depreciation and accretion	7,286	6,832
Stock based compensation	278	589
Future tax expense (recovery)	(460)	227
Foreign exchange loss	19	70
Cash flow from operations	8,578	12,134
Abandonments	(146)	(111)
Change in non-cash working capital	950	(1,543)
	9,382	10,480
Investing Activities		
Property, plant & equipment - additions	(14,230)	(13,194)
Property, plant & equipment - dispositions	157	962
Change in non-cash working capital	(282)	973
	(14,355)	(11,259)
Financing Activities		
Increase (decrease) in bank debt	3,530	(325)
Common Shares		
Issued for cash on exercise of options	162	58
Issued for cash on a flow-through basis	1,817	1,822
Repurchased for cancellation	(39)	(27)
Class A Subordinate Voting Shares		
Issued for cash on exercise of options	-	80
Repurchased for cancellation	-	(6)
	5,470	1,602
Increase (decrease) in cash	497	823
Cash, beginning of year	1,585	762
Cash, end of year	$ 2,082	$ 1,585
Supplementary information regarding cash payments:		
Interest paid during the year	$ 670	$ 493
Taxes paid during the year	$ 820	$ 152

Notes to the Consolidated Financial Statements

For the years ended December 31, 2006 and 2005

1. Accounting Policies

Consolidation

The consolidated financial statements include the accounts of (the "Company") and its wholly owned subsidiaries, Diaz Resources, Inc. and Orbit Oil & Gas Inc.

Property, Plant and Equipment

The Company follows the full cost method of accounting for petroleum and natural gas operations. Under this method, all costs of exploration for and development of petroleum and natural gas reserves are capitalized by cost centre. A separate cost centre is established for each country in which the Company operates, presently Canada and the United States. Costs include lease acquisition costs, geological and geophysical expense, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells and overhead charges directly related to exploration activities.

Proceeds on disposal of properties are normally applied as a reduction of the capitalized costs without recognition of a gain or loss, except where such a disposal would alter the depletion and depreciation rate by 20% or more.

Depletion and depreciation of capitalized costs are provided by using the unit of production method based on the Company's total estimated gross proven reserves, as determined by independent engineers. Natural gas reserves and production are converted to equivalent barrels of oil based on the relevant energy content. In determining the depletion base, the Company includes future costs to be incurred in developing proven reserves and excludes the costs of unproven land.

Depreciation is provided on furniture and fixtures at annual rates of 20%, on a declining balance basis.

An impairment loss is recognized in net earnings when the carrying amount of a cost centre is not recoverable and the carrying amount of the cost centre exceeds its fair value. The carrying amount of the cost centre is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves. If the sum of the cash flows is less than carrying amount, the impairment loss is limited to the amount by which the carrying amount exceeds the sum of:

- the fair value of proved and probable reserves; and
- the costs of unproved properties that have been subject to a separate impairment test and contain no probable reserves.

In determining the depletion and depreciation provisions for crude oil and natural gas assets, the Company includes any excess of the net book value of those crude oil and natural gas assets over the fair value.

Asset Retirement Obligation

The Company recognizes the fair value of an Asset Retirement Obligation ("ARO") as a liability in the period in which it is incurred if a reasonable estimate of fair value can be made. The present value of the estimated ARO is capitalized as part of the net capitalized asset base and the depletion of the capitalized asset retirement cost is determined on a basis consistent with depletion of the Company's other assets. With time, accretion will increase the carrying amount of the obligation. Accretion is expensed.

Cash and Cash Equivalents

Cash includes cash and cash-like short-term investments that can be liquidated into cash on less than 90 days notice. Short-term investments are comprised of risk-free, interest bearing securities.

Joint Ventures

The Company's activities are conducted jointly with others. These financial statements reflect the Company's proportionate interest in such activities.

Share Based Compensation Plan

The Company has a stock based compensation plan, which is described in Note 4.

The Company has adopted the fair value method for accounting for stock based compensation. Using the fair value method, compensation costs of stock based compensation are estimated and charged to earnings in the period of the option grant, taking into account the vesting period of the options.

Foreign Currency Translation

Foreign currency balances, including those of integrated foreign subsidiaries, are expressed in Canadian dollars on the following basis:

Monetary assets and liabilities – at the year end rate of exchange;

Other assets and liabilities – at historical rates of exchange; and

Revenues and expenses – at average rates of exchange for the period, except provisions for depreciation and depletion, which are translated on the same basis as the related assets.

Flow-Through Shares

Share capital is reduced by the future tax effect of renouncing income tax cost to the purchaser of flow-through shares when the tax pools are renounced. The tax effect is calculated using the expected rate of tax.

Revenue Recognition

Revenue associated with the sale of crude oil, natural gas and natural gas liquids owned by the Company is recognized when title passes from the Company to its customers.

Use of Accounting Estimates

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for asset retirement obligation are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

2. Bank Debt

All credit facilities that are revolving in nature must be disclosed as liabilities. Diaz utilizes a secured revolving production loan that is payable on demand and is subject to an annual review and, therefore, is considered "current" for disclosure purposes and has been disclosed under current liabilities as bank debt.

The Company has an $11,500,000 secured revolving production loan with a Canadian financial institution. The facility carries an interest rate of Prime plus 0.75%, resulting in an effective rate of 6.75% at December 31, 2006, is payable on demand and is subject to an annual review by May 31, 2007. The loan is secured by an interest in certain property, a general assignment of book debts and a $20,000,000 first floating charge demand debenture. At December 31, 2006, $10,712,000 of the loan was outstanding (2005 - $7,182,000).

3. Property, Plant and Equipment

(Thousands)	December 31 2006	Additions	December 31 2005
Land	**$ 13,719**	$ 2,077	$ 11,643
Drilling	**45,066**	7,338	37,728
Facilities	**20,573**	3,901	16,673
Other	**7,993**	612	7,378
Total	**87,351**	13,928	73,422
Accum Depletion	**(34,321)**	(6,960)	(27,361)
	53,030	6,968	46,061
Furniture & Fixtures	**955**	98	857
Accum Depreciation	**(590)**	(74)	(516)
	365	24	341
Property, Plant and Equipment	**$ 53,395**	$ 6,992	$ 46,402

At December 31, 2006, unproven property costs of $3,030,000 were excluded from the depletable cost base (2005 - $5,229,000). Administrative expenses of $191,000 related to exploration and development activities were capitalized as part of property, plant and equipment (2005 - $177,000).

For the calculation of depletion expense, estimated future costs to develop the proved reserves were added to property, plant and equipment. Future costs were $6,291,000 (2005 - $9,011,000).

The Company based its estimates on the future price quotes for U.S. gas at Nymex, adjusted for heat content and basis differential and for Canadian gas at the AECO price to the end of 2009 and held constant thereafter. Oil prices used were WTI for U.S. properties and Edmonton Light for Canadian properties, both adjusted for quality differentials.

	Price Estimates Used for Ceiling Test			
	Nymex [illegible]	AECO [illegible]	Edmonton Light [illegible]	[illegible]
2007	$ 7.87	$ 8.12	$ 74.40	$ 65.02
2008	$ 8.08	$ 8.16	$ 77.28	$ 67.50
2009	$ 7.84	$ 8.27	$ 76.80	$ 67.13

4. Share Capital

Share Capital Reorganizations

On June 9, 2005, the shareholders approved the amendment to the Articles of the Company to convert all of the Subordinate Voting Shares and Multiple Voting Shares into Common Shares on a one-for-one basis.

Authorized

Unlimited number of Common Shares, no stated par value.

Voting Rights

Common shares carry voting rights of one vote per share.

Issued

	Number of Shares	Amount (thousands)
Common Shares		
Balance, December 31, 2004	-	-
Issued on conversion of Subordinate Voting Shares [(1)]	53,828,831	14,462
Issued on conversion of Multiple Voting Shares [(1)]	5,963,055	1,780
Issued on exercise of options	128,300	58
Repurchased for cancellation	(37,500)	(7)
Issued for cash (net of offering expense of $177,837) and income tax effect of $60,000	1,667,000	1,882
Balance, December 31, 2005	61,549,686	$ 18,175
Tax effect of flow-through shares		(676)
Tax effect of share issue costs		56
Issued for cash (net of offering expense of $183,406)	2,000,000	1,818
Issued on exercise of options	343,233	162
Repurchased for cancellation	(45,000)	(39)
Total Shares Outstanding, December 31, 2006	63,847,919	$ 19,496

(1) On June 9, 2005, the shareholders approved an amendment to the Articles of the Company to change all of the Subordinate Voting Shares and Multiple Voting Shares into Common Share on a one-for-one basis.

	Amount (thousands)
Contributed Surplus	
Balance, December 31, 2004	$ 300
Options issued in 2005	589
Options exercised in 2005	(27)
Balance, December 31, 2005	862
Options issued in 2006	279
Options exercised in 2006	(42)
Excess of cost over paid up capital on share repurchases	27
Balance, December 31, 2006	$ 1,126

Normal Course Issuer Bid

Pursuant to the terms of a Normal Course Issuer Bid to purchase its shares in the market, during 2006, Diaz repurchased 45,000 Common Shares at an average price of $0.89 per share.

At December 31, 2006, Diaz was authorized to repurchase up to 3,092,000 Common Shares through the facilities of the Toronto Stock Exchange pursuant to a normal course issuer bid, which expires on September 10, 2007. Shares repurchased pursuant to the bid are cancelled.

Earnings Per Share

The treasury stock method is used to determine the dilutive effect of stock options, warrants and other dilutive instruments. Under the treasury stock method, only "in the money" dilutive instruments impact the dilution calculations.

Basic earnings per share are calculated by dividing the weighted average number of the aggregate outstanding shares during the period into net earnings attributable to the shareholders. Weighted average number of shares outstanding for 2006 were 62,000,678 (2005 – 60,170,008). Diluted weighted average shares outstanding for 2006 were 62,487,784 (2005 – 61,697,933).

Stock Option Plan

As at December 31, 2006, there are a total of 4,061,700 options granted and outstanding under the stock option plan with a weighted average exercise price of $0.68 per share. A total of 2,821,800 options with a weighted average exercise price of $0.59 are exercisable at December 31, 2006.

	2006		2005	
Fixed Options	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	**3,463,334**	**$ 0.539**	1,793,334	$ 0.315
Granted	**950,000**	**1.083**	2,025,000	0.707
Exercised	**(343,233)**	**0.355**	(328,300)	0.344
Expired / cancelled	**(8,401)**	**0.710**	(26,700)	0.710
Outstanding, end of year	**4,061,700**	**$ 0.681**	3,463,334	$ 0.539
Options exercisable, end of year	**2,821,800**	**$ 0.590**	2,133,234	$ 0.433

The following summarizes information about fixed stock options outstanding at December 31, 2006:

Exercise Price	Outstanding December 31, 2006	Weighted Average Remaining Life (years)	Exercisable December 31, 2006
$0.30 - $0.36	1,165,000	0.40	1,165,000
$0.60 - $0.68	250,000	0.21	166,600
$0.70 - $0.71	1,676,700	1.29	1,113,500
$0.80 - $0.81	20,000	0.01	10,000
$0.81 - $0.85	50,000	0.03	16,700
$0.90 - $0.95	325,000	0.26	158,400
$1.10 - $1.18	575,000	0.29	191,600
	4,061,700	2.49	2,821,800

The Company accounts for its stock based compensation plan using the fair value method, whereby compensation costs are charged to earnings in the period in which they are incurred.

The Company accounts for its stock based compensation plan using the fair value method whereby compensation costs have been recognized in the financial statements for share options granted to employees and directors. The impact on compensation costs of using the fair value method increased compensation costs for 2006 by $278,000 (2005 - $589,000).

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with assumptions as follows:

	Risk Free Interest Rate (%)	Expected Life (Years)	Expected Volatility	Dividends per Share
2004	3.00	4.0	0.62	n/a
2005	3.23	4.0	0.62	n/a
2006	4.24	4.0	0.43	n/a

5. Income Taxes

The provision for income taxes in the consolidated statement of operations and retained earnings varies from the amount that would be computed by applying the expected tax rate to earnings before income taxes. The expected tax rates used were those in effect for the periods. The principal reasons for differences between such “expected” income tax expense and the amount actually recorded are as follows:

	2006			2005		
	Canada	U.S.	Total	Canada	U.S.	Total
Tax rate	29.1%	37.0%	-	34.7%	37.0%	-
Computed expected income tax expense (recovery)	$ (616)	$ 1,163	$ 547	$ 292	$ 1,754	$ 2,046
Increase (decrease) in income taxes resulting from:						
Capital and other tax	33	14	47	26	-	26
Resource allowance	(92)	-	(92)	(398)	-	(398)
Non-deductible crown payments	103	-	103	368	-	368
Alberta Royalty Tax Credit	3	-	3	(28)	-	(28)
Non-deductible expense	118	-	118	245	-	245
Other	(34)	(138)	(172)	-	24	24
Change in tax rate	(746)	-	(746)	(151)	-	(151)
Adjusted tax pools	-	2	2	(781)	(235)	(1,016)
Actual income tax expense (recovery)	$ (1,231)	$ 1,041	$ (190)	$ (427)	$ 1,543	$ 1,116

Future income tax liability is comprised of temporary differences in the book value of the assets of the Company and the future income tax reductions at the expected future tax rates. The resulting temporary differences in future tax liabilities are as follows:

(Thousands)	2006	2005
Net book value of assets over associated tax base	$ 6,765	$ 6,770
Asset retirement obligation	(746)	(857)
Attributed Canadian royalty income	(149)	(169)
Share issue costs	(113)	(146)
Future tax liability	$ 5,757	$ 5,598

At December 31, 2006, the Company had the following tax deductions available to reduce future taxable income:

Tax Pools (Thousands)	Years Ended December 31	
	2006	2005
Canadian exploration expense	$ 9,813	$ 8,431
Canadian development expense	5,778	3,883
Undepreciated capital cost	6,775	5,700
Canadian oil and gas property expense	5,117	4,941
Other	214	244
	27,697	23,199
U.S. tax pools	3,183	2,238
Total	$ 30,880	$ 25,437

6. Asset Retirement Obligation

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with the retirement of oil and gas properties:

(Thousands)	2006	
Asset Retirement Obligation, beginning of year	**$ 2,535**	$ 2,338
Liabilities incurred	**41**	68
Liabilities settled	**(48)**	(73)
Accretion expense	**254**	202
Change in estimates	**(186)**	-
Asset Retirement Obligation, end of year	**$ 2,596**	$ 2,535

The total undiscounted amount of estimated cash flows required to settle the obligation is $5,161,000, which has been discounted using an average credit-adjusted risk free rate of 9 percent. Most of these obligations are expected to be paid between 2007 and 2015.

7. Commitments

The Company has committed to future minimum payments under an operating lease covering office facilities as follows:

	Amount (Thousands)
Year ended December 31, 2007	$ 205
Year ended December 31, 2008	$ 211
Year ended December 31, 2009	$ 216
Year ended December 31, 2010	$ 180
	$ 812

The Company has the following gas price contracts in place for future periods:

Fixed Price Volume	Fixed Price ($/Mcf)	Time Period for Contract
711 Mcfd	$ 7.81	Apr 1, 2007 - Oct 31, 2007
711 Mcfd	$ 8.04	Apr 1, 2007 - Oct 31, 2007
711 Mcfd	$ 8.99	Nov 1, 2007 - Mar 31, 2008

Costless Collar Volume	Floor Price ($/Mcf)	Ceiling Price ($/Mcf)	Time Period for Contract
1,896 Mcfd	$ 7.91	$ 10.60	Jan 1, 2007 - Mar 31, 2007
711 Mcfd	$ 8.44	$ 10.34	Nov 1, 2007 - Mar 31, 2008

8. Segmented Information

The Company's only industry segment is the exploration for and development and production of oil and natural gas. The following table sets forth the geographical segments of the Company's operations between Canada and the United States.

(Thousands)	Years Ended December 31 2006	[illegible]
Revenue (net)		
Canada	$ 8,889	$ 12,018
United States	6,036	6,549
	$ 14,925	$ 18,567
Interest Expense		
Canada	$ 670	$ 493
United States	-	-
	$ 670	$ 493
Current Taxes		
Canada	$ 33	$ 26
United States	237	863
	$ 270	$ 889
Cash Flow from Operations		
Canada	$ 3,563	$ 6,768
United States	5,015	5,366
	$ 8,578	$ 12,134
Depletion, Depreciation & Accretion		
Canada	$ 5,436	$ 5,390
United States	1,850	1,442
	$ 7,286	$ 6,832
Net Earnings (Loss)		
Canada	$ (887)	$ 1,241
United States	2,342	3,175
	$ 1,455	$ 4,416
Additions to Property, Plant & Equipment		
Canada	$ 9,090	$ 9,253
United States	5,140	3,941
	$ 14,230	$ 13,194
Identifiable Assets, Net		
Canada	$ 47,082	$ 46,472
United States	12,663	10,116
	$ 59,745	$ 56,588

9. Financial Instruments

The Company's financial instruments that are included in the balance sheet are comprised of cash, accounts receivable and all current liabilities.

Fair Values of Financial Assets and Liabilities

The fair values of financial instruments that are included in the balance sheet approximate their carrying amount due to the short-term maturity of those instruments.

Credit Risk

A substantial portion of the Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

10. Related Party Transactions

At December 31, 2006, Humboldt Capital Corporation and certain of its officers and directors owned 34% of the outstanding shares of Diaz. Diaz and Humboldt have certain common officers and directors. Humboldt's business includes the ownership, acquisition and sale of securities in other companies in the oil and gas industry and Humboldt owns significant interests in companies in the oil and gas sector, which compete with Diaz and operate jointly with Diaz, from time to time, in certain areas.

Diaz and Sharon Energy Ltd. have certain common officers and directors. In addition, at December 31, 2006, Humboldt Capital Corporation and its directors and officers owned approximately 37% of the outstanding shares of Sharon. During the past two years, Sharon participated in an exploration and land acquisition program in southern Alberta, operated by Diaz, and Diaz participated in an exploration and land acquisition program in Texas, operated by Sharon. At December 31, 2006, Sharon owed Diaz $203,000 (2005 - $376,000) through the normal course of business.

During 2006, Diaz provided certain overhead services to Humboldt Capital Corporation and Humboldt reimbursed Diaz in the amount of $204,000 (2005 - $120,000).

11. Subsequent Event

On March 26, 2007, the Company announced that it had closed its financing of 8.75% convertible unsecured subordinated debentures ("Debentures"). Debentures having an aggregate principal amount of $7,085,000 were issued, of which $625,000 of the Debentures are being held in escrow subject to receipt of final subscriber documentation which is expected prior to April 16, 2007. Research Capital Corporation and CIBC World Markets Inc. acted as agents in respect of the financing.

Corporate Information

Directors

Robert W. Lamond
Calgary, Alberta

Charles A. Teare
Calgary, Alberta

Donald K. Clark
Calgary, Alberta

Clive M. Stockdale (2)
Vancouver, British Columbia

Allan R. Twa (2) (3)
Calgary, Alberta

Raj Agrawal (1)
Calgary, Alberta

John G.F. McLeod (1) (2)
Okotoks, Alberta

Robert L. McPherson (1) (3)
Calgary, Alberta

(1) Member of the Audit Committee
(2) Member of the Compensation Committee
(3) Member of the Corporate Governance Committee

Legal Counsel

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

Officers

R.W. Lamond
President, Chairman of the Board & CEO

D.K. Clark
Vice President, Operations & COO

B.R. Perry
Chief Financial Officer

C.A. Teare
Executive Vice President

C.S. Cohen
Corporate Secretary

R.D. Arsenault
Controller

Subsidiaries

Diaz Resources, Inc.
Orbit Oil & Gas Inc.

Registrar and Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta
Toronto, Ontario

Auditors

PricewaterhouseCoopers LLP
Calgary, Alberta

Stock Exchange Listing

Toronto Stock Exchange
Trading Symbol: DZR

Diaz Resources Ltd.

Suite 1800, 633 - Sixth Avenue S.W.
Calgary, Alberta T2P 2Y5
Telephone: (403) 269-9889
Fax: (403) 269-9890
Website: www.diazresources.com
Email: info@diazresources.com

Designed by Bryan Mills Iradesso

DIAZ RESOURCES LTD.

WWW.DIAZRESOURCES.COM

Suite 1800, 633 6 Avenue SW
Calgary, AB T2P 2Y5 Canada

T 403.269.9889 F 403.269.9890